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SINO-SOVIET BLOC ECONOMIC ACTIVITIES RELATING TO
ECONOMIC DEFENSE POLICY

Summary

The Sino-Soviet bloc has been expanding its economic activities in the Free World since 1953; enlarging trade relations with both industrialized and underdeveloped countries, providing long-term credits, and offering technical assistance to the underdeveloped areas. With a few exceptions, it appears that bloc efforts under this expanded program have not been primarily directed toward securing strategic materials but have had broader economic and political motivation. In most cases where the bloc has sought strategic items as part of expanded trade the move has seemed to be influenced by a desire to break down the control system or create dissension within the Free World over trade controls. The bloc has also sought to increase its influence in underdeveloped countries through exploiting desires for rapid economic growth and stable export markets. As part of this program the bloc has negotiated loan agreements providing for repayment directly through exports from the underdeveloped countries and has shown a willingness to take surpluses from countries experiencing marketing difficulties. These efforts, also, do not appear to have been primarily linked to a desire to secure strategic materials.

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Sino-Soviet Bloc Economic Activities Relating to
Economic Defense Policy

This report is intended to be a concise summary of Sino-Soviet bloc economic activities in Free World countries with particular reference to those aspects which have some important direct relation to economic defense policy. The terms of reference call for reviewing bloc activities as they have:

a. Been used to obtain strategic goods, technology and services, either by purchase or barter, or by the extension of capital assistance repayable by exports of strategic goods to the bloc.

b. Taken advantage of outstanding commodity and trade problems in Free World countries for the purpose of increasing bloc influence. Broader questions of other economic motives and the political objectives being pursued by the bloc are not considered, but this is not intended to detract from their relevance for determining economic defense policy.

I. BACKGROUND

With the expansion of bloc foreign economic activities beginning in 1953, the Sino-Soviet bloc has been engaged in a worldwide program of enlarging existing trade agreements and negotiating new agreements, providing long-term credits to underdeveloped countries for economic development and arms purchases, providing technical assistance, and increasing participation in trade fairs. By August 1956 between \$900,000,000 and \$1,000,000,000 of long-term credits offered by the bloc had been accepted - more than 90 percent going to Egypt, Yugoslavia, Afghanistan and India. The number of trade and payments agreements between bloc and Free World countries rose from 98 in December 1953 to 190 by the end of April 1956. In 1955 bloc trade with the Free World reached nearly \$4.5 billion as compared with only \$3 billion in 1953. The European bloc accounts for about \$1.4 billion of the total increase. In the same period the level of intra-Bloc trade showed little change, but still accounted for the bulk of the foreign trade of the member countries. Looked at from the other side of the coin, only a few Free World countries conducted a significant proportion of their trade with the bloc. In 1955 bloc trade represented less than 10 percent of the total in all free world countries except Afghanistan, Egypt, Iceland, Finland, Turkey, and Iran. Although Western Europe remains the principal bloc trading partner, trade with underdeveloped countries has been making up an increasing proportion of the bloc's total trade turnover. While still a net importer of capital goods from the Free World as a whole, the bloc has increased sharply exports of such goods to underdeveloped areas. Bloc imports from the underdeveloped areas, largely foodstuffs and raw materials, have been rising steadily since 1953.

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The bloc has the capacity to double or even triple its trade with the Free World over the next few years if it should consider such a step economically or politically advantageous. If bloc exports by 1960 were double the 1955 level they would still represent only about 1.5 percent of anticipated bloc production. However, the prospects are that bloc trade - particularly that of the satellites - with the Free World will continue to expand moderately in the next few years. While there are economic incentives to modify the traditional strict adherence to autarky, bloc plans still indicate that most of the area's growing requirements are to be met from internal bloc production, and while some increases in trade with the Free World are anticipated, they are unlikely to be carried to a point where the bloc would become avoidably dependent on the Free World for any significant proportion of its critical supplies or even a large part of its consumption of medium priority goods.

It is beyond the scope of the present paper to consider the extent to which increased trade has a measurable counterpart in bloc ability to exert greater influence on the foreign relations of the countries to which its economic offensive has been directed. Increased economic relations will no doubt have an impact on the recipients, but increased trade has been only one element in the larger fabric of the new bloc diplomacy and its share of the credit for recent Soviet gains in the political sphere cannot satisfactorily be isolated. On the question of the vulnerability of underdeveloped countries to the Sino-Soviet economic offensive, EIC-R-14 states:

"The economic problems of underdeveloped countries tend to make these countries receptive to Sino-Soviet Bloc offers of closer economic relations. This is not to say, however, that economic considerations will in all cases be paramount in determining a country's response to Bloc blandishments or that the acceptance of such offers necessarily means that the Bloc will be able to exert pressures successfully on the country to obtain political concessions. Vulnerability in the latter sense depends on a complex of political, strategic, geographic, cultural, and other factors beyond the scope of this report."

II. THE BLOC ECONOMIC OFFENSIVE IN RELATION TO TRADE IN STRATEGIC MATERIALS

The question to be considered at this point may be phrased as follows: To what extent and under what circumstances has the Sino-Soviet bloc been able to obtain strategic goods, technology, and services, from the Free World as a result of the expanded economic offensive?

With a few exceptions it is difficult to isolate bloc activities so as to identify precisely those cases where strategic goods moved or may move to the bloc as part of a deliberate effort to secure such goods as the price of barter trade. Again with a few exceptions there is no evidence that the bloc was badly in need of most of the strategic items secured and thus actively negotiated purchases with that purpose in mind. The more relevant considerations ruling appear to be deliberate efforts to create dissension over trade controls

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within the Free World -- even on a small scale and largely for political reasons -- and at times a coincident desire to secure access to some strategic commodities. The lack of strategic goods in a Free World country, or the adamant refusal to breach trade controls, has not effectively barred trade arrangements in most cases. At the same time the bait of a larger volume of trade has been dangled before the Free World countries, and the price demanded (again probably most importantly for political reasons) sometimes involves violation of strategic control systems. Offers of substantially increased trade with Western Europe and Japan have been multiplying, in almost all cases including an attempt by the Bloc to secure strategic goods and circumvent Free World controls. In offers to underdeveloped countries in South and Southeast Asia, the Far East, the Middle East and Latin America, the bulk of items sought are not strategic list commodities, and the primary reason for bloc offers lies in broader economic and political objectives.

The following listings of instances of where the Sino-Soviet bloc has obtained strategic goods as part of its expanded economic activities is not intended to cover every single transaction but merely to indicate the general nature of such transactions.

A. Bloc Purchases of Strategic Goods from COCOM Countries

Under COCOM exceptions procedure the bloc has secured or definitely arranged for purchase of strategic goods in a number of instances. In the 1956 trade agreements with the USSR, Denmark has agreed to supply two fast merchant ships, nine refrigerator ships, and other items subject to COCOM controls. This trade agreement ended the hiatus in formal trade relations between the USSR and Denmark which has existed since the lapse of the previous agreement in mid-1954. Negotiations had been protracted by Soviet insistence that Danish tankers be included in the agreement. The Danes, eager to resume formal trade relations with the USSR, eventually offered fast merchant vessels instead of tankers.

Turkey shipped about 17,000 metric tons of boracite to the bloc in 1955, about half of total Turkish boracite exports. Turkish officials claimed that because of foreign exchange difficulties they cannot cut off boracite exports to the bloc unless Free World markets are available. On assurance that the US would help -- even to the extent of cutting back US exports -- Turkey agreed in July 1956 to take steps to curtail boracite exports to the bloc.

The 1956 Netherlands-USSR trade protocol included three cargo vessels on COCOM lists, and the matter is under COCOM review. Western Germany has shipped nickel alloy steel to East Germany, supposedly because of necessity to insure adequate deliveries of brown coal from East Germany. The 1956 Netherlands-Hungary agreement calls for Dutch exports of roller bearings. Norway has been shipping aluminum to the USSR for some time, and this usual trade has been provided for in recent new agreements. The Soviet Union has also been seeking asdic (sounding) devices from Norway, and the Norwegians have indicated that they are considering supplying a small number.

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Extensive and increasing use of exceptions procedures have been used by many of the COCOM countries to license shipments to Communist China, a reflection of the desire to exploit a trade potential but also, and importantly, an indication of Western European and Japanese dissatisfaction with the COCOM-CHINCOM differential. In the first six months of 1956 requests for exceptions on shipments to Communist China presented to CHINCOM were valued at \$16.4 million compared with \$10.2 million in all of 1955 and \$3.1 million in all of 1954.

Japan has adhered strictly to COCOM-CHINCOM controls in its trade relations with the bloc. About 80 percent of Japan's trade with bloc countries is with Communist China. If the CHINCOM differential were to be removed, the potential for trade with Communist China would rise sharply. The Communist Chinese government has in its last four annual trade agreements with private Japanese trading groups tried to create dissatisfaction in Japan with CHINCOM controls. In these agreements goods on control lists have been sought in return for specific materials of greatest interest to the Japanese. The agreements establish three categories of goods, with trade within each category being matched against certain classes of goods by each country. Thus under one category Chinese Communist exports of iron ore, manganese, pig iron and coal are matched against Japanese exports of such controlled items as copper ingots, aluminium, steel plates and tubes, galvanized iron sheets, etc. Such agreements provide pressure on the Japanese to seek reductions in controls in return for necessary imports, although as yet there have been no exports of strategic materials to Communist China, outside of those under normal exceptions procedure.

The Soviet Union has made offers of large increases in overall trade with the UK, France, and Japan -- but included in the offers to purchase were a wide range and large quantity of strategic goods. These offers are in early negotiating stages, but there will undoubtedly be increasing pressure on the Free World countries to modify controls to meet avowed desires to increase the level of trade. The large volume of shipments of copper wire from the Free World to the bloc following the 1954 COCOM list revisions is well-known. The readiness of the bloc to make these purchases was matched by the eagerness of Free World suppliers to exploit the situation.

B. The Role of Strategic Materials in Bloc Trade with Underdeveloped Areas of the Free World

The most important shipments of rubber to Communist China were a result of the five-year agreement entered into in 1952 calling for the annual exchange of 50,000 tons of Ceylonese rubber for 270,000 tons of Communist China's rice. The Communists were undoubtedly motivated by the desire to drive a wedge in the effective coverage of Western controls as well as by their desire to secure rubber. When the agreement was negotiated, Ceylon urgently needed rice and found the Communist offer of premium prices for rubber attractive at a time of declining rubber prices.

Rubber was also shipped from Burma to Communist China in 1953, in 1955 and in 1956. With the extended use of previous exceptions procedures under CHINCOM controls permitting liberalized shipment of rubber from other Asian producers to Communist China there has been no evidence of a rush to purchase.

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Communist China has always been able to get Indonesian and Malayan rubber via the European bloc, to which controls did not apply, but it is believed that the bulk of requirements are being secured from Ceylon. From time to time Communist China's supplies of rubber have been sufficient to allow some reexport to the European bloc countries. However, the provision for extending exceptions procedures to permit "reasonable" shipments of rubber has opened the way for progressive whittling away of the remaining restrictions on rubber. Malayan rubber merchants, anxious to open up a market in Communist China at time when rubber prices are slipping, are actively seeking to increase their exports. This places the Communists in a position to exploit dissension between the US and its allies, who have different attitudes toward the trade, and to work for further reduction of controls on the full range of the CHINCOM differential.

Strategic goods as defined in control lists have not been moving from the Middle East or Africa. Although unconfirmed reports indicate that strategic materials are being transhipped from Tangier and Bierut, the quantities are insignificant. It is believed that no overt shipments from Latin America have been in violation of Battle Act lists. Rather the Latin American countries appear to have maintained careful legal conformity with control lists. The bloc countries appear to realize the special nature of US-Latin American relations and trade offers have not been based on a shopping list of strategic materials, although bloc propaganda belabors Western controls as being against the best interest of the Latin American countries.

Large scale trade and credit agreements between the bloc and other countries in the world, e.g. Afghanistan, Egypt, India, Iceland, and more recently Indonesia, have been negotiated. But as yet there is no indication of significant movement of strategic materials to the bloc as a result. Egypt and Iceland have little to offer along this line. Widespread Soviet activities in Afghanistan involve, among other things, exploitation of sulphur deposits. A contract was negotiated in 1955 providing for a six-year Soviet monopoly for development of sulphur deposits with the aim of providing 30,000 tons of sulphur-bearing ore for export to the Soviet Union. The project is believed to have passed beyond the technical survey stage and active development may have begun. The development credits granted to India include planned shipment of goods in repayments and may involve such an item as industrial diamonds. The Indonesian agreements with the bloc have included rubber. Bloc offers to assist in developing petroleum resources have been made to India, Israel, and Indonesia; Czechoslovakia has bid on a refinery for Syria; and the bloc has expressed interest in oil developments in Latin America and elsewhere. Since the bloc is a net exporter of petroleum, there is little likelihood that the bloc would seek compensation in petroleum products. Outside of the credits to Yugoslavia discussed below, it appears that the major credits offered by the bloc (plus a grant to Cambodia) have not been tied to securing strategic materials.

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C. Bloc Arrangements with Yugoslavia and Finland

The post-Stalin bloc efforts to woo Yugoslavia have included major economic programs with important strategic commodity aspects. Although not a COCOM participant, Yugoslavia has refrained from shipping strategic goods because of its interest in maintaining US assistance. However, more recently the bloc has been extending large scale credits and entering into a wide range of trade agreements with Yugoslavia. Yugoslavia recently took a significant step toward closer economic and political relations with the bloc by signing an inter-governmental agreement providing for a joint Soviet Union - East German credit of \$175 million to develop the Yugoslav aluminum industry. Along with all the significant political and general economic ramifications, this agreement commits Yugoslavia to future deliveries of significant quantities of aluminum to the bloc - possibly as much as 50,000 tons annually under the initial credit terms.

The Soviet Union is reported to have offered to finance the development of Yugoslav copper deposits - a project for which Western financing has been under negotiation. Although the Yugoslavs announced Soviet willingness to accept repayment in products other than copper, there is no assurance that this would be the eventual result. The reconstruction of two lead - zinc mines, and the construction of a mercury smelting mill, all under terms of a Yugoslav-USSR credit agreement are also reportedly underway, but there is no specific information as to provisions for repayment from their output.

The bloc has been receiving a number of strategic list items from Finland, but this trade cannot be presumed a result of the post-Stalin economic offensive. Finland's dependence on trade with the bloc grew out of the reparations required by the Finnish-Soviet peace treaty. These reparations were not only large but required the production of strategic items to bloc order. When the reparations were completed, the industries established were dependent upon the bloc market and the export to the bloc of such goods as ships, power station equipment, and cobalt continued. The Soviet Union pursued its policy of fostering Finnish exports to the Bloc by arranging tri-lateral payments involving other bloc countries and later by offering gold loans, and making some payments for goods in convertible currencies.

III. BLOC EXPLOITATION OF COMMODITY AND TRADE PROBLEMS IN THE FREE WORLD

The bloc economic offensive has been able to exploit the desire in underdeveloped countries for rapid economic growth and stable export markets. Bloc loan terms usually provide for repayment directly through the exports of underdeveloped countries, and in some cases the bloc has agreed to take surpluses that have been difficult for the underdeveloped country to dispose of in normal markets. In an even broader sense, increased Soviet interest

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in world trade - following the years of traditional autarky and coming at a time when competition for markets within the West was growing - opened up visions of high levels of profitable trade for both highly developed and underdeveloped countries in the Free World. Even though this is doubtful, it has influence on the minds of business men and has created strong pressures on many governments.

In some cases the bloc has attempted to woo underdeveloped countries by offering to purchase their exports at premium prices. However, the goods which the bloc offers in exchange sometimes also carry high prices. Thus the Burmese have claimed that the terms of exchange on their barter deals with the USSR put them at a 10-30 percent disadvantage. Moreover, there is some evidence that bloc purchases of commodities from underdeveloped countries may be accompanied by increased bloc offers to export the same commodities. In such cases the underdeveloped country may not really increase its total exports by the amount sold to the bloc and may in the process lose part of its preferred free world markets.

The most striking examples of bloc exploitation of commodity problems in the Free World are the Burmese rice agreements and the Egyptian cotton-arms deal. Other instances of opportunities pursued by the bloc include the aforementioned Ceylon-Communist China rice-rubber agreement, the bloc purchases of fish from Iceland, the increasing role of the bloc as a market for Turkey's staple exports, large bloc purchases of Uruguayan wool and meat, and bloc willingness to increase purchases from Argentina at a time when traditional Argentina exports were experiencing market problems.

Bloc purchases of rice from Burma in the course of this campaign rose from an insignificant level to where at least 25 percent of Burma's rice exports is under some form of commitment to the bloc. Burma's economy is heavily rice-oriented and these agreements were negotiated at a time when Burma was burdened with a seemingly overwhelming rice surplus. The recent improvement in the rice market, and a measure of Burmese disillusionment with the so-called benefits of barter trade, have reduced the opportunity for further bloc exploitation, but the situation remains serious for Western interests.

The general features of the Egyptian cotton-arms deal are well-known, and the results are still unfolding. In view of world cotton market problems, the great dependence of Egypt on cotton as an earner of foreign exchange, and Egypt's military aspirations, the willingness of the bloc to engage in assuring a market for about 30 percent of Egypt's cotton exports has improved the fishing in troubled waters.

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The general interest of one crop economies and countries experiencing balance of payments difficulties in trade with the bloc has opened up channels for increasing bloc influence. The quantities taken by the bloc - though small compared to the large economic base of the bloc - represent important quantities to the exporting countries. The receptivity of the underdeveloped countries to bloc overtures is heightened by bloc willingness to offer capital goods, technicians, favorable credit terms; and arms to meet national military aspirations. Moreover, bloc offers are appealing as a device for improving bargaining power of underdeveloped countries with the developed countries of the West -- particularly the US. There is no doubt, also, that bloc overtures have been able to capitalize on the discontent in some countries with trade, tariff, and surplus disposal policies of the developed countries.

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